

110TH CONGRESS  
1ST SESSION

# S. 1081

To amend the Internal Revenue Code of 1986 to impose a flat tax only on individual taxable earned income and business taxable income, and for other purposes.

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## IN THE SENATE OF THE UNITED STATES

APRIL 10, 2007

Mr. SPECTER introduced the following bill; which was read twice and referred to the Committee on Finance

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## A BILL

To amend the Internal Revenue Code of 1986 to impose a flat tax only on individual taxable earned income and business taxable income, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE; TABLE OF CONTENTS; AMEND-**  
4 **MENT OF 1986 CODE.**

5 (a) SHORT TITLE.—This Act may be cited as the  
6 “Flat Tax Act of 2007”.

7 (b) TABLE OF CONTENTS.—The table of contents for  
8 this Act is as follows:

Sec. 1. Short title; table of contents; amendment of 1986 Code.

- Sec. 2. Flat tax on individual taxable earned income and business taxable income.
- Sec. 3. Repeal of estate and gift taxes.
- Sec. 4. Additional repeals.
- Sec. 5. Effective dates.

(c) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

**SEC. 2. FLAT TAX ON INDIVIDUAL TAXABLE EARNED INCOME AND BUSINESS TAXABLE INCOME.**

(a) IN GENERAL.—Subchapter A of chapter 1 of subtitle A is amended to read as follows:

**“Subchapter A—Determination of Tax Liability**

“PART I. TAX ON INDIVIDUALS

“PART II. TAX ON BUSINESS ACTIVITIES

**“PART I—TAX ON INDIVIDUALS**

- “Sec. 1. Tax imposed.
- “Sec. 2. Standard deduction.
- “Sec. 3. Deduction for cash charitable contributions.
- “Sec. 4. Deduction for home acquisition indebtedness.
- “Sec. 5. Definitions and special rules.
- “Sec. 6. Dependent defined.
- “Sec. 7. Inflation adjustment.

**“SEC. 1. TAX IMPOSED.**

“(a) IMPOSITION OF TAX.—There is hereby imposed on every individual a tax equal to 20 percent of the taxable earned income of such individual.

1       “(b) TAXABLE EARNED INCOME.—For purposes of  
 2 this section, the term ‘taxable earned income’ means the  
 3 excess (if any) of—

4               “(1) the earned income received or accrued dur-  
 5 ing the taxable year, over

6               “(2) the sum of—

7                       “(A) the standard deduction,

8                       “(B) the deduction for cash charitable con-  
 9 tributions, and

10                      “(C) the deduction for home acquisition in-  
 11 debtedness, for such taxable year.

12       “(c) EARNED INCOME.—For purposes of this sec-  
 13 tion—

14               “(1) IN GENERAL.—The term ‘earned income’  
 15 means wages, salaries, or professional fees, and  
 16 other amounts received from sources within the  
 17 United States as compensation for personal services  
 18 actually rendered, but does not include that part of  
 19 compensation derived by the taxpayer for personal  
 20 services rendered by the taxpayer to a corporation  
 21 which represents a distribution of earnings or profits  
 22 rather than a reasonable allowance as compensation  
 23 for the personal services actually rendered.

24               “(2) TAXPAYER ENGAGED IN TRADE OR BUSI-  
 25 NESS.—In the case of a taxpayer engaged in a trade

1 or business in which both personal services and cap-  
 2 ital are material income-producing factors, under  
 3 regulations prescribed by the Secretary, a reasonable  
 4 allowance as compensation for the personal services  
 5 rendered by the taxpayer, not in excess of 30 per-  
 6 cent of the taxpayer's share of the net profits of  
 7 such trade or business, shall be considered as earned  
 8 income.

9 **“SEC. 2. STANDARD DEDUCTION.**

10 “(a) IN GENERAL.—For purposes of this subtitle, the  
 11 term ‘standard deduction’ means the sum of—

12 “(1) the basic standard deduction, plus

13 “(2) the additional standard deduction.

14 “(b) BASIC STANDARD DEDUCTION.—For purposes  
 15 of subsection (a), the basic standard deduction is—

16 “(1) 200 percent of the dollar amount in effect  
 17 under paragraph (3) of the taxable year in the case  
 18 of—

19 “(A) a joint return, or

20 “(B) a surviving spouse (as defined in sec-  
 21 tion 5(a)),

22 “(2) \$18,750 in the case of a head of household  
 23 (as defined in section 5(b)), or

24 “(3) \$12,500 in any other case.

1       “(c) ADDITIONAL STANDARD DEDUCTION.—For pur-  
 2 poses of subsection (a), the additional standard deduction  
 3 is \$6,250 for each dependent (as defined in section 6)—

4               “(1) whose earned income for the calendar year  
 5 in which the taxable year of the taxpayer begins is  
 6 less than the basic standard deduction specified in  
 7 subsection (b)(3), or

8               “(2) who is a child of the taxpayer and who—

9                       “(A) has not attained the age of 19 at the  
 10 close of the calendar year in which the taxable  
 11 year of the taxpayer begins, or

12                      “(B) is a student who has not attained the  
 13 age of 24 at the close of such calendar year.

14 **“SEC. 3. DEDUCTION FOR CASH CHARITABLE CONTRIBU-**  
 15 **TIONS.**

16       “(a) GENERAL RULE.—For purposes of this part,  
 17 there shall be allowed as a deduction any charitable con-  
 18 tribution (as defined in subsection (b)) not to exceed  
 19 \$3,125 (50 percent of such amount in the case of a mar-  
 20 ried individual filing a separate return), payment of which  
 21 is made within the taxable year.

22       “(b) CHARITABLE CONTRIBUTION DEFINED.—For  
 23 purposes of this section, the term ‘charitable contribution’  
 24 means a contribution or gift of cash or its equivalent to  
 25 or for the use of the following:

1           “(1) A State, a possession of the United States,  
2           or any political subdivision of any of the foregoing,  
3           or the United States or the District of Columbia,  
4           but only if the contribution or gift is made for exclu-  
5           sively public purposes.

6           “(2) A corporation, trust, or community chest,  
7           fund, or foundation—

8                   “(A) created or organized in the United  
9                   States or in any possession thereof, or under  
10                  the law of the United States, any State, the  
11                  District of Columbia, or any possession of the  
12                  United States,

13                   “(B) organized and operated exclusively  
14                   for religious, charitable, scientific, literary, or  
15                   educational purposes, or to foster national or  
16                   international amateur sports competition (but  
17                   only if no part of its activities involve the provi-  
18                   sion of athletic facilities or equipment), or for  
19                   the prevention of cruelty to children or animals,

20                   “(C) no part of the net earnings of which  
21                   inures to the benefit of any private shareholder  
22                   or individual, and

23                   “(D) which is not disqualified for tax ex-  
24                   emption under section 501(c)(3) by reason of  
25                   attempting to influence legislation, and which

1           does not participate in, or intervene in (includ-  
 2           ing the publishing or distributing of state-  
 3           ments), any political campaign on behalf of (or  
 4           in opposition to) any candidate for public office.

5           A contribution or gift by a corporation to a trust,  
 6           chest, fund, or foundation shall be deductible by rea-  
 7           son of this paragraph only if it is to be used within  
 8           the United States or any of its possessions exclu-  
 9           sively for purposes specified in subparagraph (B).  
 10          Rules similar to the rules of section 501(j) shall  
 11          apply for purposes of this paragraph.

12           “(3) A post or organization of war veterans, or  
 13           an auxiliary unit or society of, or trust or foundation  
 14           for, any such post or organization—

15           “(A) organized in the United States or any  
 16           of its possessions, and

17           “(B) no part of the net earnings of which  
 18           inures to the benefit of any private shareholder  
 19           or individual.

20           “(4) In the case of a contribution or gift by an  
 21           individual, a domestic fraternal society, order, or as-  
 22           sociation, operating under the lodge system, but only  
 23           if such contribution or gift is to be used exclusively  
 24           for religious, charitable, scientific, literary, or edu-

1        cational purposes, or for the prevention of cruelty to  
 2        children or animals.

3            “(5) A cemetery company owned and operated  
 4        exclusively for the benefit of its members, or any  
 5        corporation chartered solely for burial purposes as a  
 6        cemetery corporation and not permitted by its char-  
 7        ter to engage in any business not necessarily inci-  
 8        dent to that purpose, if such company or corporation  
 9        is not operated for profit and no part of the net  
 10       earnings of such company or corporation inures to  
 11       the benefit of any private shareholder or individual.  
 12 For purposes of this section, the term ‘charitable contribu-  
 13 tion’ also means an amount treated under subsection (d)  
 14 as paid for the use of an organization described in para-  
 15 graph (2), (3), or (4).

16        “(c) DISALLOWANCE OF DEDUCTION IN CERTAIN  
 17 CASES AND SPECIAL RULES.—

18            “(1) SUBSTANTIATION REQUIREMENT FOR CER-  
 19 TAIN CONTRIBUTIONS.—

20            “(A) GENERAL RULE.—No deduction shall  
 21        be allowed under subsection (a) for any con-  
 22        tribution of \$250 or more unless the taxpayer  
 23        substantiates the contribution by a contempora-  
 24       neous written acknowledgment of the contribu-



tion by the donee organization that meets the requirements of subparagraph (B).

“(B) CONTENT OF ACKNOWLEDGMENT.—

An acknowledgment meets the requirements of this subparagraph if it includes the following information:

“(i) The amount of cash contributed.

“(ii) Whether the donee organization provided any goods or services in consideration, in whole or in part, for any contribution described in clause (i).

“(iii) A description and good faith estimate of the value of any goods or services referred to in clause (ii) or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.

For purposes of this subparagraph, the term ‘intangible religious benefit’ means any intangible religious benefit which is provided by an organization organized exclusively for religious purposes and which generally is not sold in a commercial transaction outside the donative context.

“(C) CONTEMPORANEOUS.—For purposes of subparagraph (A), an acknowledgment shall

1 be considered to be contemporaneous if the tax-  
 2 payer obtains the acknowledgment on or before  
 3 the earlier of—

4 “(i) the date on which the taxpayer  
 5 files a return for the taxable year in which  
 6 the contribution was made, or

7 “(ii) the due date (including exten-  
 8 sions) for filing such return.

9 “(D) SUBSTANTIATION NOT REQUIRED  
 10 FOR CONTRIBUTIONS REPORTED BY THE  
 11 DONEE ORGANIZATION.—Subparagraph (A)  
 12 shall not apply to a contribution if the donee  
 13 organization files a return, on such form and in  
 14 accordance with such regulations as the Sec-  
 15 retary may prescribe, which includes the infor-  
 16 mation described in subparagraph (B) with re-  
 17 spect to the contribution.

18 “(E) REGULATIONS.—The Secretary shall  
 19 prescribe such regulations as may be necessary  
 20 or appropriate to carry out the purposes of this  
 21 paragraph, including regulations that may pro-  
 22 vide that some or all of the requirements of this  
 23 paragraph do not apply in appropriate cases.

24 “(2) DENIAL OF DEDUCTION WHERE CON-  
 25 TRIBUTION FOR LOBBYING ACTIVITIES.—No deduc-

1       tion shall be allowed under this section for a con-  
 2       tribution to an organization which conducts activities  
 3       to which section 11(d)(2)(C)(i) applies on matters of  
 4       direct financial interest to the donor's trade or busi-  
 5       ness, if a principal purpose of the contribution was  
 6       to avoid Federal income tax by securing a deduction  
 7       for such activities under this section which would be  
 8       disallowed by reason of section 11(d)(2)(C) if the  
 9       donor had conducted such activities directly. No de-  
 10      duction shall be allowed under section 11(d) for any  
 11      amount for which a deduction is disallowed under  
 12      the preceding sentence.

13      “(d) AMOUNTS PAID TO MAINTAIN CERTAIN STU-  
 14      DENTS AS MEMBERS OF TAXPAYER'S HOUSEHOLD.—

15           “(1) IN GENERAL.—Subject to the limitations  
 16      provided by paragraph (2), amounts paid by the tax-  
 17      payer to maintain an individual (other than a de-  
 18      pendent, as defined in section 6, or a relative of the  
 19      taxpayer) as a member of such taxpayer's household  
 20      during the period that such individual is—

21           “(A) a member of the taxpayer's household  
 22      under a written agreement between the tax-  
 23      payer and an organization described in para-  
 24      graph (2), (3), or (4) of subsection (b) to imple-  
 25      ment a program of the organization to provide

1 educational opportunities for pupils or students  
2 in private homes, and

3 “(B) a full-time pupil or student in the  
4 twelfth or any lower grade at an educational or-  
5 ganization located in the United States which  
6 normally maintains a regular faculty and cur-  
7 riculum and normally has a regularly enrolled  
8 body of pupils or students in attendance at the  
9 place where its educational activities are regu-  
10 larly carried on, shall be treated as amounts  
11 paid for the use of the organization.

12 “(2) LIMITATIONS.—

13 “(A) AMOUNT.—Paragraph (1) shall apply  
14 to amounts paid within the taxable year only to  
15 the extent that such amounts do not exceed \$50  
16 multiplied by the number of full calendar  
17 months during the taxable year which fall with-  
18 in the period described in paragraph (1). For  
19 purposes of the preceding sentence, if 15 or  
20 more days of a calendar month fall within such  
21 period such month shall be considered as a full  
22 calendar month.

23 “(B) COMPENSATION OR REIMBURSE-  
24 MENT.—Paragraph (1) shall not apply to any  
25 amount paid by the taxpayer within the taxable

1           year if the taxpayer receives any money or  
2           other property as compensation or reimburse-  
3           ment for maintaining the individual in the tax-  
4           payer's household during the period described  
5           in paragraph (1).

6           “(3) RELATIVE DEFINED.—For purposes of  
7           paragraph (1), the term ‘relative of the taxpayer’  
8           means an individual who, with respect to the tax-  
9           payer, bears any of the relationships described in  
10          subparagraphs (A) through (G) of section 6(d)(2).

11          “(4) NO OTHER AMOUNT ALLOWED AS DEDUC-  
12          TION.—No deduction shall be allowed under sub-  
13          section (a) for any amount paid by a taxpayer to  
14          maintain an individual as a member of the tax-  
15          payer's household under a program described in  
16          paragraph (1)(A) except as provided in this sub-  
17          section.

18          “(e) DENIAL OF DEDUCTION FOR CERTAIN TRAVEL  
19          EXPENSES.—No deduction shall be allowed under this sec-  
20          tion for traveling expenses (including amounts expended  
21          for meals and lodging) while away from home, whether  
22          paid directly or by reimbursement, unless there is no sig-  
23          nificant element of personal pleasure, recreation, or vaca-  
24          tion in such travel.

1       “(f) DISALLOWANCE OF DEDUCTIONS IN CERTAIN  
 2 CASES.—For disallowance of deductions for contributions  
 3 to or for the use of Communist controlled organizations,  
 4 see section 11(a) of the Internal Security Act of 1950 (50  
 5 U.S.C. 790).

6       “(g) TREATMENT OF CERTAIN AMOUNTS PAID TO OR  
 7 FOR THE BENEFIT OF INSTITUTIONS OF HIGHER EDU-  
 8 CATION.—

9               “(1) IN GENERAL.—For purposes of this sec-  
 10 tion, 80 percent of any amount described in para-  
 11 graph (2) shall be treated as a charitable contribu-  
 12 tion.

13              “(2) AMOUNT DESCRIBED.—For purposes of  
 14 paragraph (1), an amount is described in this para-  
 15 graph if—

16                   “(A) the amount is paid by the taxpayer to  
 17 or for the benefit of an educational organiza-  
 18 tion—

19                           “(i) which is described in subsection  
 20 (d)(1)(B), and

21                           “(ii) which is an institution of higher  
 22 education (as defined in section 3304(f)),  
 23 and

24                   “(B) such amount would be allowable as a  
 25 deduction under this section but for the fact

1           that the taxpayer receives (directly or indi-  
2           rectly) as a result of paying such amount the  
3           right to purchase tickets for seating at an ath-  
4           letic event in an athletic stadium of such insti-  
5           tution.

6 If any portion of a payment is for the purchase of such  
7 tickets, such portion and the remaining portion (if any)  
8 of such payment shall be treated as separate amounts for  
9 purposes of this subsection.

10       “(h) OTHER CROSS REFERENCES.—

11           “(1) For treatment of certain organizations  
12       providing child care, see section 501(k).

13           “(2) For charitable contributions of partners,  
14       see section 702.

15           “(3) For treatment of gifts for benefit of or use  
16       in connection with the Naval Academy as gifts to or  
17       for the use of the United States, see section 6973  
18       of title 10, United States Code.

19           “(4) For treatment of gifts accepted by the  
20       Secretary of State, the Director of the International  
21       Communication Agency, or the Director of the  
22       United States International Development Coopera-  
23       tion Agency, as gifts to or for the use of the United  
24       States, see section 25 of the State Department Basic  
25       Authorities Act of 1956.

1           “(5) For treatment of gifts of money accepted  
 2           by the Attorney General for credit to the ‘Com-  
 3           missary Funds, Federal Prisons’ as gifts to or for  
 4           the use of the United States, see section 4043 of  
 5           title 18, United States Code.

6           “(6) For charitable contributions to or for the  
 7           use of Indian tribal governments (or subdivisions of  
 8           such governments), see section 7871.

9   **“SEC. 4. DEDUCTION FOR HOME ACQUISITION INDEBTED-**  
 10                   **NESS.**

11       “(a) GENERAL RULE.—For purposes of this part,  
 12       there shall be allowed as a deduction all qualified residence  
 13       interest paid or accrued within the taxable year.

14       “(b) QUALIFIED RESIDENCE INTEREST DEFINED.—  
 15       The term ‘qualified residence interest’ means any interest  
 16       which is paid or accrued during the taxable year on acqui-  
 17       sition indebtedness with respect to any qualified residence  
 18       of the taxpayer. For purposes of the preceding sentence,  
 19       the determination of whether any property is a qualified  
 20       residence of the taxpayer shall be made as of the time  
 21       the interest is accrued.

22       “(c) ACQUISITION INDEBTEDNESS.—

23               “(1) IN GENERAL.—The term ‘acquisition in-  
 24       debtedness’ means any indebtedness which—



1           “(A) is incurred in acquiring, constructing,  
2           or substantially improving any qualified resi-  
3           dence of the taxpayer, and

4           “(B) is secured by such residence.

5       Such term also includes any indebtedness secured by  
6       such residence resulting from the refinancing of in-  
7       debtedness meeting the requirements of the pre-  
8       ceding sentence (or this sentence); but only to the  
9       extent the amount of the indebtedness resulting  
10      from such refinancing does not exceed the amount of  
11      the refinanced indebtedness.

12           “(2) DOLLAR LIMITATION.—The aggregate  
13      amount treated as acquisition indebtedness for any  
14      period shall not exceed \$125,000 (50 percent of such  
15      amount in the case of a married individual filing a  
16      separate return).

17           “(d) TREATMENT OF INDEBTEDNESS INCURRED ON  
18      OR BEFORE OCTOBER 13, 1987.—

19           “(1) IN GENERAL.—In the case of any pre-October 13, 1987, indebtedness—

21           “(A) such indebtedness shall be treated as  
22      acquisition indebtedness, and

23           “(B) the limitation of subsection (c)(2)  
24      shall not apply.

1           “(2) REDUCTION IN LIMITATION.—The limita-  
 2           tion of subsection (c)(2) shall be reduced (but not  
 3           below zero) by the aggregate amount of outstanding  
 4           pre-October 13, 1987, indebtedness.

5           “(3) PRE-OCTOBER 13, 1987, INDEBTEDNESS.—  
 6           The term ‘pre-October 13, 1987, indebtedness’  
 7           means—

8                   “(A) any indebtedness which was incurred  
 9                   on or before October 13, 1987, and which was  
 10                  secured by a qualified residence on October 13,  
 11                  1987, and at all times thereafter before the in-  
 12                  terest is paid or accrued, or

13                   “(B) any indebtedness which is secured by  
 14                   the qualified residence and was incurred after  
 15                   October 13, 1987, to refinance indebtedness de-  
 16                   scribed in subparagraph (A) (or refinanced in-  
 17                   debtedness meeting the requirements of this  
 18                   subparagraph) to the extent (immediately after  
 19                   the refinancing) the principal amount of the in-  
 20                   debtedness resulting from the refinancing does  
 21                   not exceed the principal amount of the refi-  
 22                   nanced indebtedness (immediately before the re-  
 23                   financing).

1           “(4) LIMITATION ON PERIOD OF REFI-  
 2       NANCING.—Subparagraph (B) of paragraph (3)  
 3       shall not apply to any indebtedness after—

4           “(A) the expiration of the term of the in-  
 5       debtedness described in paragraph (3)(A), or

6           “(B) if the principal of the indebtedness  
 7       described in paragraph (3)(A) is not amortized  
 8       over its term, the expiration of the term of the  
 9       first refinancing of such indebtedness (or if ear-  
 10      lier, the date which is 30 years after the date  
 11      of such first refinancing).

12       “(e) OTHER DEFINITIONS AND SPECIAL RULES.—  
 13      For purposes of this section—

14       “(1) QUALIFIED RESIDENCE.—For purposes of  
 15      this subsection—

16       “(A) IN GENERAL.—Except as provided in  
 17      subparagraph (C), the term ‘qualified residence’  
 18      means the principal residence of the taxpayer.

19       “(B) MARRIED INDIVIDUALS FILING SEPA-  
 20      RATE RETURNS.—If a married couple does not  
 21      file a joint return for the taxable year—

22           “(i) such couple shall be treated as 1  
 23          taxpayer for purposes of subparagraph  
 24          (A), and

1                   “(ii) each individual shall be entitled  
 2                   to take into account  $\frac{1}{2}$  of the principal  
 3                   residence unless both individuals consent  
 4                   in writing to 1 individual taking into ac-  
 5                   count the principal residence.

6                   “(C) PRE-OCTOBER 13, 1987, INDEBTED-  
 7                   NESS.—In the case of any pre-October 13,  
 8                   1987, indebtedness, the term ‘qualified resi-  
 9                   dence’ has the meaning given that term in sec-  
 10                  tion 163(h)(4), as in effect on the day before  
 11                  the date of enactment of this subparagraph.

12                  “(2) SPECIAL RULE FOR COOPERATIVE HOUS-  
 13                  ING CORPORATIONS.—Any indebtedness secured by  
 14                  stock held by the taxpayer as a tenant-stockholder in  
 15                  a cooperative housing corporation shall be treated as  
 16                  secured by the house or apartment which the tax-  
 17                  payer is entitled to occupy as such a tenant-stock-  
 18                  holder. If stock described in the preceding sentence  
 19                  may not be used to secure indebtedness, indebted-  
 20                  ness shall be treated as so secured if the taxpayer  
 21                  establishes to the satisfaction of the Secretary that  
 22                  such indebtedness was incurred to acquire such  
 23                  stock.

24                  “(3) UNENFORCEABLE SECURITY INTERESTS.—  
 25                  Indebtedness shall not fail to be treated as secured

1 by any property solely because, under any applicable  
 2 State or local homestead or other debtor protection  
 3 law in effect on August 16, 1986, the security inter-  
 4 est is ineffective or the enforceability of the security  
 5 interest is restricted.

6 “(4) SPECIAL RULES FOR ESTATES AND  
 7 TRUSTS.—For purposes of determining whether any  
 8 interest paid or accrued by an estate or trust is  
 9 qualified residence interest, any residence held by  
 10 such estate or trust shall be treated as a qualified  
 11 residence of such estate or trust if such estate or  
 12 trust establishes that such residence is a qualified  
 13 residence of a beneficiary who has a present interest  
 14 in such estate or trust or an interest in the resid-  
 15 uary of such estate or trust.

16 **“SEC. 5. DEFINITIONS AND SPECIAL RULES.**

17 “(a) DEFINITION OF SURVIVING SPOUSE.—

18 “(1) IN GENERAL.—For purposes of this part,  
 19 the term ‘surviving spouse’ means a taxpayer—

20 “(A) whose spouse died during either of  
 21 the taxpayer’s 2 taxable years immediately pre-  
 22 ceding the taxable year, and

23 “(B) who maintains as the taxpayer’s  
 24 home a household which constitutes for the tax-

1           able year the principal place of abode (as a  
2           member of such household) of a dependent—

3                   “(i) who (within the meaning of sec-  
4                   tion 6, determined without regard to sub-  
5                   sections (b)(1), (b)(2), and (d)(1)(B)) is a  
6                   son, stepson, daughter, or stepdaughter of  
7                   the taxpayer, and

8                   “(ii) with respect to whom the tax-  
9                   payer is entitled to a deduction for the tax-  
10                  able year under section 2.

11       For purposes of this paragraph, an individual shall  
12       be considered as maintaining a household only if  
13       over one-half of the cost of maintaining the house-  
14       hold during the taxable year is furnished by such in-  
15       dividual.

16       “(2)   LIMITATIONS.—Notwithstanding para-  
17       graph (1), for purposes of this part a taxpayer shall  
18       not be considered to be a surviving spouse—

19                   “(A) if the taxpayer has remarried at any  
20                   time before the close of the taxable year, or

21                   “(B) unless, for the taxpayer’s taxable  
22                   year during which the taxpayer’s spouse died, a  
23                   joint return could have been made under the  
24                   provisions of section 6013 (without regard to  
25                   subsection (a)(3) thereof).

1           “(3) SPECIAL RULE WHERE DECEASED SPOUSE  
 2           WAS IN MISSING STATUS.—If an individual was in a  
 3           missing status (within the meaning of section  
 4           6013(f)(3)) as a result of service in a combat zone  
 5           and if such individual remains in such status until  
 6           the date referred to in subparagraph (A) or (B),  
 7           then, for purposes of paragraph (1)(A), the date on  
 8           which such individual dies shall be treated as the  
 9           earlier of the date determined under subparagraph  
 10          (A) or the date determined under subparagraph (B):

11                 “(A) The date on which the determination  
 12                 is made under section 556 of title 37 of the  
 13                 United States Code or under section 5566 of  
 14                 title 5 of such Code (whichever is applicable)  
 15                 that such individual died while in such missing  
 16                 status.

17                 “(B) Except in the case of the combat  
 18                 zone designated for purposes of the Vietnam  
 19                 conflict, the date which is 2 years after the date  
 20                 designated as the date of termination of com-  
 21                 batant activities in that zone.

22          “(b) DEFINITION OF HEAD OF HOUSEHOLD.—

23                 “(1) IN GENERAL.—For purposes of this part,  
 24                 an individual shall be considered a head of a house-  
 25                 hold if, and only if, such individual is not married

1 at the close of such individual's taxable year, is not  
2 a surviving spouse (as defined in subsection (a)),  
3 and either—

4 “(A) maintains as such individual's home a  
5 household which constitutes for more than one-  
6 half of such taxable year the principal place of  
7 abode, as a member of such household, of—

8 “(i) a qualifying child of the indi-  
9 vidual (as defined in section 6(c), deter-  
10 mined without regard to section 6(e)), but  
11 not if such child—

12 “(I) is married at the close of the  
13 taxpayer's taxable year, and

14 “(II) is not a dependent of such  
15 individual by reason of section 6(b)(2)  
16 or 6(b)(3), or both, or

17 “(ii) any other person who is a de-  
18 pendent of the taxpayer, if the taxpayer is  
19 entitled to a deduction for the taxable year  
20 for such person under section 2, or

21 “(B) maintains a household which con-  
22 stitutes for such taxable year the principal place  
23 of abode of the father or mother of the tax-  
24 payer, if the taxpayer is entitled to a deduction



1           for the taxable year for such father or mother  
2           under section 2.

3           For purposes of this paragraph, an individual shall  
4           be considered as maintaining a household only if  
5           over one-half of the cost of maintaining the house-  
6           hold during the taxable year is furnished by such in-  
7           dividual.

8           “(2) DETERMINATION OF STATUS.—For pur-  
9           poses of this subsection—

10                   “(A) an individual who is legally separated  
11                   from such individual’s spouse under a decree of  
12                   divorce or of separate maintenance shall not be  
13                   considered as married,

14                   “(B) a taxpayer shall be considered as not  
15                   married at the close of such taxpayer’s taxable  
16                   year if at any time during the taxable year such  
17                   taxpayer’s spouse is a nonresident alien, and

18                   “(C) a taxpayer shall be considered as  
19                   married at the close of such taxpayer’s taxable  
20                   year if such taxpayer’s spouse (other than a  
21                   spouse described in subparagraph (B)) died  
22                   during the taxable year.

23           “(3) LIMITATIONS.—Notwithstanding para-  
24           graph (1), for purposes of this part, a taxpayer shall  
25           not be considered to be a head of a household—

1                   “(A) if at any time during the taxable year  
2                   the taxpayer is a nonresident alien, or

3                   “(B) by reason of an individual who would  
4                   not be a dependent for the taxable year but  
5                   for—

6                               “(i) subparagraph (H) of section  
7                               6(d)(2), or

8                               “(ii) paragraph (3) of section 6(d).

9           “(c) CERTAIN MARRIED INDIVIDUALS LIVING  
10 APART.—For purposes of this part, an individual shall be  
11 treated as not married at the close of the taxable year  
12 if such individual is so treated under the provisions of sec-  
13 tion 7703(b).

14 **“SEC. 6. DEPENDENT DEFINED.**

15           “(a) IN GENERAL.—For purposes of this subtitle, the  
16 term ‘dependent’ means—

17                   “(1) a qualifying child, or

18                   “(2) a qualifying relative.

19           “(b) EXCEPTIONS.—For purposes of this section—

20                   “(1) DEPENDENTS INELIGIBLE.—If an indi-  
21 vidual is a dependent of a taxpayer for any taxable  
22 year of such taxpayer beginning in a calendar year,  
23 such individual shall be treated as having no depend-  
24 ents for any taxable year of such individual begin-  
25 ning in such calendar year.

1           “(2) MARRIED DEPENDENTS.—An individual  
 2           shall not be treated as a dependent of a taxpayer  
 3           under subsection (a) if such individual has made a  
 4           joint return with the individual’s spouse under sec-  
 5           tion 6013 for the taxable year beginning in the cal-  
 6           endar year in which the taxable year of the taxpayer  
 7           begins.

8           “(3) CITIZENS OR NATIONALS OF OTHER COUN-  
 9           TRIES.—

10           “(A) IN GENERAL.—The term ‘dependent’  
 11           does not include an individual who is not a cit-  
 12           izen or national of the United States unless  
 13           such individual is a resident of the United  
 14           States or a country contiguous to the United  
 15           States.

16           “(B) EXCEPTION FOR ADOPTED CHILD.—  
 17           Subparagraph (A) shall not exclude any child of  
 18           a taxpayer (within the meaning of subsection  
 19           (f)(1)(B)) from the definition of ‘dependent’  
 20           if—

21           “(i) for the taxable year of the tax-  
 22           payer, the child has the same principal  
 23           place of abode as the taxpayer and is a  
 24           member of the taxpayer’s household, and

1                   “(ii) the taxpayer is a citizen or na-  
2                   tional of the United States.

3           “(c) QUALIFYING CHILD.—For purposes of this sec-  
4   tion—

5                   “(1) IN GENERAL.—The term ‘qualifying child’  
6           means, with respect to any taxpayer for any taxable  
7           year, an individual—

8                   “(A) who bears a relationship to the tax-  
9           payer described in paragraph (2),

10                   “(B) who has the same principal place of  
11           abode as the taxpayer for more than one-half of  
12           such taxable year,

13                   “(C) who meets the age requirements of  
14           paragraph (3), and

15                   “(D) who has not provided over one-half of  
16           such individual’s own support for the calendar  
17           year in which the taxable year of the taxpayer  
18           begins.

19                   “(2) RELATIONSHIP.—For purposes of para-  
20           graph (1)(A), an individual bears a relationship to  
21           the taxpayer described in this paragraph if such in-  
22           dividual is—

23                   “(A) a child of the taxpayer or a descend-  
24           ant of such a child, or

1           “(B) a brother, sister, stepbrother, or step-  
 2           sister of the taxpayer or a descendant of any  
 3           such relative.

4           “(3) AGE REQUIREMENTS.—

5           “(A) IN GENERAL.—For purposes of para-  
 6           graph (1)(C), an individual meets the require-  
 7           ments of this paragraph if such individual—

8                   “(i) has not attained the age of 19 as  
 9                   of the close of the calendar year in which  
 10                  the taxable year of the taxpayer begins, or

11                   “(ii) is a student who has not attained  
 12                  the age of 24 as of the close of such cal-  
 13                  endar year.

14           “(B) SPECIAL RULE FOR DISABLED.—In  
 15           the case of an individual who is permanently  
 16           and totally disabled at any time during such  
 17           calendar year, the requirements of subpara-  
 18           graph (A) shall be treated as met with respect  
 19           to such individual.

20           “(4) SPECIAL RULE RELATING TO 2 OR MORE  
 21           CLAIMING QUALIFYING CHILD.—

22           “(A) IN GENERAL.—Except as provided in  
 23           subparagraph (B), if (but for this paragraph)  
 24           an individual may be and is claimed as a quali-  
 25           fying child by 2 or more taxpayers for a taxable

1           year beginning in the same calendar year, such  
 2           individual shall be treated as the qualifying  
 3           child of the taxpayer who is—

4                       “(i) a parent of the individual, or

5                       “(ii) if clause (i) does not apply, the  
 6           taxpayer with the highest adjusted gross  
 7           income for such taxable year.

8                       “(B) MORE THAN 1 PARENT CLAIMING  
 9           QUALIFYING CHILD.—If the parents claiming  
 10          any qualifying child do not file a joint return  
 11          together, such child shall be treated as the  
 12          qualifying child of—

13                      “(i) the parent with whom the child  
 14          resided for the longest period of time dur-  
 15          ing the taxable year, or

16                      “(ii) if the child resides with both par-  
 17          ents for the same amount of time during  
 18          such taxable year, the parent with the  
 19          highest adjusted gross income.

20           “(d) QUALIFYING RELATIVE.—For purposes of this  
 21   section—

22                      “(1) IN GENERAL.—The term ‘qualifying rel-  
 23          ative’ means, with respect to any taxpayer for any  
 24          taxable year, an individual—

1           “(A) who bears a relationship to the tax-  
2           payer described in paragraph (2),

3           “(B) with respect to whom the taxpayer  
4           provides over one-half of the individual’s sup-  
5           port for the calendar year in which such taxable  
6           year begins, and

7           “(C) who is not a qualifying child of such  
8           taxpayer or of any other taxpayer for any tax-  
9           able year beginning in the calendar year in  
10          which such taxable year begins.

11          “(2) RELATIONSHIP.—For purposes of para-  
12          graph (1)(A), an individual bears a relationship to  
13          the taxpayer described in this paragraph if the indi-  
14          vidual is any of the following with respect to the tax-  
15          payer:

16               “(A) A child or a descendant of a child.

17               “(B) A brother, sister, stepbrother, or  
18               stepsister.

19               “(C) The father or mother, or an ancestor  
20               of either.

21               “(D) A stepfather or stepmother.

22               “(E) A son or daughter of a brother or sis-  
23               ter of the taxpayer.

24               “(F) A brother or sister of the father or  
25               mother of the taxpayer.

1           “(G) A son-in-law, daughter-in-law, father-  
 2           in-law, mother-in-law, brother-in-law, or sister-  
 3           in-law.

4           “(H) An individual (other than an indi-  
 5           vidual who at any time during the taxable year  
 6           was the spouse, determined without regard to  
 7           section 7703, of the taxpayer) who, for the tax-  
 8           able year of the taxpayer, has the same prin-  
 9           cipal place of abode as the taxpayer and is a  
 10          member of the taxpayer’s household.

11          “(3) SPECIAL RULE RELATING TO MULTIPLE  
 12          SUPPORT AGREEMENTS.—For purposes of paragraph  
 13          (1)(C), over one-half of the support of an individual  
 14          for a calendar year shall be treated as received from  
 15          the taxpayer if—

16               “(A) no one person contributed over one-  
 17               half of such support,

18               “(B) over one-half of such support was re-  
 19               ceived from 2 or more persons each of whom,  
 20               but for the fact that any such person alone did  
 21               not contribute over one-half of such support,  
 22               would have been entitled to claim such indi-  
 23               vidual as a dependent for a taxable year begin-  
 24               ning in such calendar year,



1 “(C) the taxpayer contributed over 10 per-  
2 cent of such support, and

3 “(D) each person described in subpara-  
4 graph (B) (other than the taxpayer) who con-  
5 tributed over 10 percent of such support files a  
6 written declaration (in such manner and form  
7 as the Secretary may by regulations prescribe)  
8 that such person will not claim such individual  
9 as a dependent for any taxable year beginning  
10 in such calendar year.

11 “(4) SPECIAL RULE RELATING TO INCOME OF  
12 HANDICAPPED DEPENDENTS.—

13 “(A) IN GENERAL.—For purposes of para-  
14 graph (1)(B), the gross income of an individual  
15 who is permanently and totally disabled at any  
16 time during the taxable year shall not include  
17 income attributable to services performed by the  
18 individual at a sheltered workshop if—

19 “(i) the availability of medical care at  
20 such workshop is the principal reason for  
21 the individual’s presence there, and

22 “(ii) the income arises solely from ac-  
23 tivities at such workshop which are inci-  
24 dent to such medical care.

1 “(B) SHELTERED WORKSHOP DEFINED.—

2 For purposes of subparagraph (A), the term

3 ‘sheltered workshop’ means a school—

4 “(i) which provides special instruction

5 or training designed to alleviate the dis-

6 ability of the individual, and

7 “(ii) which is operated by an organi-

8 zation described in section 501(c)(3) and

9 exempt from tax under section 501(a), or

10 by a State, a possession of the United

11 States, any political subdivision of any of

12 the foregoing, the United States, or the

13 District of Columbia.

14 “(5) SPECIAL RULES FOR SUPPORT.—For pur-

15 poses of this subsection—

16 “(A) payments to a spouse which are in-

17 cludible in the gross income of such spouse

18 shall not be treated as a payment by the payor

19 spouse for the support of any dependent, and

20 “(B) in the case of the remarriage of a

21 parent, support of a child received from the

22 parent’s spouse shall be treated as received

23 from the parent.

24 “(e) SPECIAL RULE FOR DIVORCED PARENTS.—

1           “(1) IN GENERAL.—Notwithstanding subsection  
2           (c)(1)(B), (c)(4), or (d)(1)(C), if—

3           “(A) a child receives over one-half of the  
4           child’s support during the calendar year from  
5           the child’s parents—

6           “(i) who are divorced or legally sepa-  
7           rated under a decree of divorce or separate  
8           maintenance,

9           “(ii) who are separated under a writ-  
10          ten separation agreement, or

11          “(iii) who live apart at all times dur-  
12          ing the last 6 months of the calendar year,  
13          and

14          “(B) such child is in the custody of 1 or  
15          both of the child’s parents for more than one-  
16          half of the calendar year, such child shall be  
17          treated as being the qualifying child or quali-  
18          fying relative of the noncustodial parent for a  
19          calendar year if the requirements described in  
20          paragraph (2) or (3) are met.

21          “(2) EXCEPTION WHERE CUSTODIAL PARENT  
22          RELEASES CLAIM TO EXEMPTION FOR THE YEAR.—  
23          For purposes of paragraph (1), the requirements de-  
24          scribed in this paragraph are met with respect to  
25          any calendar year if—

1           “(A) the custodial parent signs a written  
 2           declaration (in such manner and form as the  
 3           Secretary may by regulations prescribe) that  
 4           such custodial parent will not claim such child  
 5           as a dependent for any taxable year beginning  
 6           in such calendar year, and

7           “(B) the noncustodial parent attaches such  
 8           written declaration to the noncustodial parent’s  
 9           return for the taxable year beginning during  
 10          such calendar year.

11          “(3) EXCEPTION FOR CERTAIN PRE-1985 IN-  
 12          STRUMENTS.—

13           “(A) IN GENERAL.—For purposes of para-  
 14           graph (1), the requirements described in this  
 15           paragraph are met with respect to any calendar  
 16           year if—

17           “(i) a qualified pre-1985 instrument  
 18           between the parents applicable to the tax-  
 19           able year beginning in such calendar year  
 20           provides that the noncustodial parent shall  
 21           be entitled to any deduction allowable  
 22           under section 151 for such child, and

23           “(ii) the noncustodial parent provides  
 24           at least \$600 for the support of such child  
 25           during such calendar year.

1 For purposes of this subparagraph, amounts ex-  
 2 pended for the support of a child or children  
 3 shall be treated as received from the noncusto-  
 4 dial parent to the extent that such parent pro-  
 5 vided amounts for such support.

6 “(B) QUALIFIED PRE-1985 INSTRUMENT.—  
 7 For purposes of this paragraph, the term  
 8 ‘qualified pre-1985 instrument’ means any de-  
 9 cree of divorce or separate maintenance or writ-  
 10 ten agreement—

11 “(i) which is executed before January  
 12 1, 1985,

13 “(ii) which on such date contains the  
 14 provision described in subparagraph (A)(i),  
 15 and

16 “(iii) which is not modified on or after  
 17 such date in a modification which expressly  
 18 provides that this paragraph shall not  
 19 apply to such decree or agreement.

20 “(4) CUSTODIAL PARENT AND NONCUSTODIAL  
 21 PARENT.—For purposes of this subsection—

22 “(A) CUSTODIAL PARENT.—The term ‘cus-  
 23 todial parent’ means the parent having custody  
 24 for the greater portion of the calendar year.

1                   “(B) NONCUSTODIAL PARENT.—The term  
2                   ‘noncustodial parent’ means the parent who is  
3                   not the custodial parent.

4                   “(5) EXCEPTION FOR MULTIPLE-SUPPORT  
5                   AGREEMENTS.—This subsection shall not apply in  
6                   any case where over one-half of the support of the  
7                   child is treated as having been received from a tax-  
8                   payer under the provision of subsection (d)(3).

9                   “(6) SPECIAL RULE FOR SUPPORT RECEIVED  
10                  FROM NEW SPOUSE OF PARENT.—For purposes of  
11                  this subsection, in the case of the remarriage of a  
12                  parent, support of a child received from the parent’s  
13                  spouse shall be treated as received from the parent.

14                  “(f) OTHER DEFINITIONS AND RULES.—For pur-  
15                  poses of this section—

16                  “(1) CHILD DEFINED.—

17                         “(A) IN GENERAL.—The term ‘child’  
18                         means an individual who is—

19                                 “(i) a son, daughter, stepson, or step-  
20                                 daughter of the taxpayer, or

21                                 “(ii) an eligible foster child of the tax-  
22                                 payer.

23                         “(B) ADOPTED CHILD.—In determining  
24                         whether any of the relationships specified in  
25                         subparagraph (A)(i) or paragraph (4) exists, a

1           legally adopted individual of the taxpayer, or an  
 2           individual who is lawfully placed with the tax-  
 3           payer for legal adoption by the taxpayer, shall  
 4           be treated as a child of such individual by  
 5           blood.

6           “(C) ELIGIBLE FOSTER CHILD.—For pur-  
 7           poses of subparagraph (A)(ii), the term ‘eligible  
 8           foster child’ means an individual who is placed  
 9           with the taxpayer by an authorized placement  
 10          agency or by judgment, decree, or other order  
 11          of any court of competent jurisdiction.

12          “(2) STUDENT DEFINED.—The term ‘student’  
 13          means an individual who during each of 5 calendar  
 14          months during the calendar year in which the tax-  
 15          able year of the taxpayer begins—

16               “(A) is a full-time student at an edu-  
 17               cational organization described in section  
 18               3(d)(1)(B), or

19               “(B) is pursuing a full-time course of insti-  
 20               tutional on-farm training under the supervision  
 21               of an accredited agent of an educational organi-  
 22               zation described in section 3(d)(1)(B) or of a  
 23               State or political subdivision of a State.

24          “(3) DETERMINATION OF HOUSEHOLD STA-  
 25          TUS.—An individual shall not be treated as a mem-

1       ber of the taxpayer’s household if at any time during  
 2       the taxable year of the taxpayer the relationship be-  
 3       tween such individual and the taxpayer is in viola-  
 4       tion of local law.

5           “(4) BROTHER AND SISTER.—The terms  
 6       ‘brother’ and ‘sister’ include a brother or sister by  
 7       the half blood.

8           “(5) SPECIAL SUPPORT TEST IN CASE OF STU-  
 9       DENTS.—For purposes of subsections (c)(1)(D) and  
 10      (d)(1)(C), in the case of an individual who is—

11           “(A) a child of the taxpayer, and

12           “(B) a student, amounts received as schol-  
 13      arships for study at an educational organization  
 14      described in section 3(d)(1)(B) shall not be  
 15      taken into account.

16           “(6) TREATMENT OF MISSING CHILDREN.—

17           “(A) IN GENERAL.—Solely for the pur-  
 18      poses referred to in subparagraph (B), a child  
 19      of the taxpayer—

20           “(i) who is presumed by law enforce-  
 21      ment authorities to have been kidnaped by  
 22      someone who is not a member of the fam-  
 23      ily of such child or the taxpayer, and

24           “(ii) who had, for the taxable year in  
 25      which the kidnaping occurred, the same



principal place of abode as the taxpayer for more than one-half of the portion of such year before the date of the kidnaping, shall be treated as meeting the requirement of subsection (c)(1)(B) with respect to a taxpayer for all taxable years ending during the period that the child is kidnaped.

“(B) PURPOSES.—Subparagraph (A) shall apply solely for purposes of determining—

“(i) the deduction under section 2(c),  
and

“(ii) whether an individual is a surviving spouse or a head of a household (as such terms are defined in section 5).

“(C) COMPARABLE TREATMENT OF CERTAIN QUALIFYING RELATIVES.—For purposes of this section, a child of the taxpayer—

“(i) who is presumed by law enforcement authorities to have been kidnaped by someone who is not a member of the family of such child or the taxpayer, and

“(ii) who was (without regard to this paragraph) a qualifying relative of the taxpayer for the portion of the taxable year before the date of the kidnaping, shall be

1           treated as a qualifying relative of the tax-  
 2           payer for all taxable years ending during  
 3           the period that the child is kidnaped.

4           “(D) TERMINATION OF TREATMENT.—  
 5           Subparagraphs (A) and (C) shall cease to apply  
 6           as of the first taxable year of the taxpayer be-  
 7           ginning after the calendar year in which there  
 8           is a determination that the child is dead (or, if  
 9           earlier, in which the child would have attained  
 10          age 18).

11   **“SEC. 7. INFLATION ADJUSTMENT.**

12          “(a) IN GENERAL.—In the case of any taxable year  
 13       beginning in a calendar year after 2008, each dollar  
 14       amount contained in sections 2(b), 2(c), 3(a), and 4(c)(2)  
 15       shall be increased by an amount equal to—

16           “(1) such dollar amount, multiplied by  
 17           “(2) the cost-of-living adjustment for the cal-  
 18       endar year in which the taxable year begins.

19          “(b) COST-OF-LIVING ADJUSTMENT.—For purposes  
 20       of subsection (a), the cost-of-living adjustment for any cal-  
 21       endar year is the percentage (if any) by which—

22           “(1) the CPI for the preceding calendar year,  
 23       exceeds  
 24           “(2) the CPI for calendar year 2007.

1       “(c) CPI FOR ANY CALENDAR YEAR.—For purposes  
 2 of subsection (b), the CPI for any calendar year is the  
 3 average of the Consumer Price Index as of the close of  
 4 the 12-month period ending on August 31 of such cal-  
 5 endar year.

6       “(d) CONSUMER PRICE INDEX.—For purposes of  
 7 subsection (c), the term ‘Consumer Price Index’ means the  
 8 last Consumer Price Index for all-urban consumers pub-  
 9 lished by the Department of Labor. For purposes of the  
 10 preceding sentence, the revision of the Consumer Price  
 11 Index which is most consistent with the Consumer Price  
 12 Index for calendar year 1986 shall be used.

13       “(e) ROUNDING.—If any increase determined under  
 14 subsection (a) is not a multiple of \$50, such amount shall  
 15 be rounded to the next lowest multiple of \$50.

## 16       **“PART II—TAX ON BUSINESS ACTIVITIES**

“Sec. 11. Tax imposed on business activities.

### 17       **“SEC. 11. TAX IMPOSED ON BUSINESS ACTIVITIES.**

18       “(a) TAX IMPOSED.—There is hereby imposed on  
 19 every person engaged in a business activity located in the  
 20 United States a tax equal to 20 percent of the business  
 21 taxable income of such person.

22       “(b) LIABILITY FOR TAX.—The tax imposed by this  
 23 section shall be paid by the person engaged in the business

1 activity, whether such person is an individual, partnership,  
 2 corporation, or otherwise.

3 “(c) BUSINESS TAXABLE INCOME.—

4 “(1) IN GENERAL.—For purposes of this sec-  
 5 tion, the term ‘business taxable income’ means gross  
 6 active income reduced by the deductions specified in  
 7 subsection (d).

8 “(2) GROSS ACTIVE INCOME.—For purposes of  
 9 paragraph (1), the term ‘gross active income’ means  
 10 gross income other than investment income.

11 “(d) DEDUCTIONS.—

12 “(1) IN GENERAL.—The deductions specified in  
 13 this subsection are—

14 “(A) the cost of business inputs for the  
 15 business activity,

16 “(B) the compensation (including contribu-  
 17 tions to qualified retirement plans but not in-  
 18 cluding other fringe benefits) paid for employ-  
 19 ees performing services in such activity, and

20 “(C) the cost of personal and real property  
 21 used in such activity.

22 “(2) BUSINESS INPUTS.—

23 “(A) IN GENERAL.—For purposes of para-  
 24 graph (1)(A), the term ‘cost of business inputs’  
 25 means—

1 “(i) the actual cost of goods, services,  
 2 and materials, whether or not resold dur-  
 3 ing the taxable year, and

4 “(ii) the actual cost, if reasonable, of  
 5 travel and entertainment expenses for busi-  
 6 ness purposes.

7 “(B) PURCHASES OF GOODS AND SERV-  
 8 ICES EXCLUDED.—Such term shall not include  
 9 purchases of goods and services provided to em-  
 10 ployees or owners.

11 “(C) CERTAIN LOBBYING AND POLITICAL  
 12 EXPENDITURES EXCLUDED.—

13 “(i) IN GENERAL.—Such term shall  
 14 not include any amount paid or incurred in  
 15 connection with—

16 “(I) influencing legislation,

17 “(II) participation in, or inter-  
 18 vention in, any political campaign on  
 19 behalf of (or in opposition to) any  
 20 candidate for public office,

21 “(III) any attempt to influence  
 22 the general public, or segments there-  
 23 of, with respect to elections, legislative  
 24 matters, or referendums, or

1           “(IV) any direct communication  
2           with a covered executive branch offi-  
3           cial in an attempt to influence the of-  
4           ficial actions or positions of such offi-  
5           cial.

6           “(ii) EXCEPTION FOR LOCAL LEGISLA-  
7           TION.—In the case of any legislation of  
8           any local council or similar governing  
9           body—

10           “(I) clause (i)(I) shall not apply,  
11           and

12           “(II) such term shall include all  
13           ordinary and necessary expenses (in-  
14           cluding, but not limited to, traveling  
15           expenses described in subparagraph  
16           (A)(iii) and the cost of preparing tes-  
17           timony) paid or incurred during the  
18           taxable year in carrying on any trade  
19           or business—

20           “(aa) in direct connection  
21           with appearances before, submis-  
22           sion of statements to, or sending  
23           communications to the commit-  
24           tees, or individual members, of  
25           such council or body with respect

1 to legislation or proposed legisla-  
2 tion of direct interest to the tax-  
3 payer, or

4 “(bb) in direct connection  
5 with communication of informa-  
6 tion between the taxpayer and an  
7 organization of which the tax-  
8 payer is a member with respect  
9 to any such legislation or pro-  
10 posed legislation which is of di-  
11 rect interest to the taxpayer and  
12 to such organization, and that  
13 portion of the dues so paid or in-  
14 curred with respect to any orga-  
15 nization of which the taxpayer is  
16 a member which is attributable  
17 to the expenses of the activities  
18 carried on by such organization.

19 “(iii) APPLICATION TO DUES OF TAX-  
20 EXEMPT ORGANIZATIONS.—Such term  
21 shall include the portion of dues or other  
22 similar amounts paid by the taxpayer to an  
23 organization which is exempt from tax  
24 under this subtitle which the organization  
25 notifies the taxpayer under section

6033(e)(1)(A)(ii) is allocable to expenditures to which clause (i) applies.

“(iv) INFLUENCING LEGISLATION.—  
For purposes of this subparagraph—

“(I) IN GENERAL.—The term ‘influencing legislation’ means any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of legislation.

“(II) LEGISLATION.—The term ‘legislation’ has the meaning given that term in section 4911(e)(2).

“(v) OTHER SPECIAL RULES.—

“(I) EXCEPTION FOR CERTAIN TAXPAYERS.—In the case of any taxpayer engaged in the trade or business of conducting activities described in clause (i), clause (i) shall not apply to expenditures of the taxpayer in conducting such activities directly on behalf of another person (but shall apply to payments by such other per-



son to the taxpayer for conducting  
such activities).

“(II) DE MINIMIS EXCEPTION.—

“(aa) IN GENERAL.—Clause  
(i) shall not apply to any in-  
house expenditures for any tax-  
able year if such expenditures do  
not exceed \$2,000. In deter-  
mining whether a taxpayer ex-  
ceeds the \$2,000 limit, there  
shall not be taken into account  
overhead costs otherwise allocable  
to activities described in sub-  
clauses (I) and (IV) of clause (i).

“(bb) IN-HOUSE EXPENDI-  
TURES.—For purposes of provi-  
sion (aa), the term ‘in-house ex-  
penditures’ means expenditures  
described in subclauses (I) and  
(IV) of clause (i) other than pay-  
ments by the taxpayer to a per-  
son engaged in the trade or busi-  
ness of conducting activities de-  
scribed in clause (i) for the con-  
duct of such activities on behalf

1 of the taxpayer, or dues or other  
 2 similar amounts paid or incurred  
 3 by the taxpayer which are allo-  
 4 cable to activities described in  
 5 clause (i).

6 “(III) EXPENSES INCURRED IN  
 7 CONNECTION WITH LOBBYING AND  
 8 POLITICAL ACTIVITIES.—Any amount  
 9 paid or incurred for research for, or  
 10 preparation, planning, or coordination  
 11 of, any activity described in clause (i)  
 12 shall be treated as paid or incurred in  
 13 connection with such activity.

14 “(vi) COVERED EXECUTIVE BRANCH  
 15 OFFICIAL.—For purposes of this subpara-  
 16 graph, the term ‘covered executive branch  
 17 official’ means—

18 “(I) the President,

19 “(II) the Vice President,

20 “(III) any officer or employee of  
 21 the White House Office of the Execu-  
 22 tive Office of the President, and the 2  
 23 most senior level officers of each of  
 24 the other agencies in such Executive  
 25 Office, and

1 “(IV) any individual serving in a  
 2 position in level I of the Executive  
 3 Schedule under section 5312 of title  
 4 5, United States Code, any other indi-  
 5 vidual designated by the President as  
 6 having Cabinet level status, and any  
 7 immediate deputy of such an indi-  
 8 vidual.

9 “(vii) SPECIAL RULE FOR INDIAN  
 10 TRIBAL GOVERNMENTS.—For purposes of  
 11 this subparagraph, an Indian tribal gov-  
 12 ernment shall be treated in the same man-  
 13 ner as a local council or similar governing  
 14 body.

15 “(viii) CROSS REFERENCE.—

“For reporting requirements and alternative taxes related to this subsection, see  
 section 6033(e).

16 “(e) CARRYOVER OF EXCESS DEDUCTIONS.—

17 “(1) IN GENERAL.—If the aggregate deductions  
 18 for any taxable year exceed the gross active income  
 19 for such taxable year, the amount of the deductions  
 20 specified in subsection (d) for the succeeding taxable  
 21 year (determined without regard to this subsection)  
 22 shall be increased by the sum of—

23 “(A) such excess, plus

1           “(B) the product of such excess and the 3-  
 2           month Treasury rate for the last month of such  
 3           taxable year.

4           “(2) 3-MONTH TREASURY RATE.—For purposes  
 5           of paragraph (1), the 3-month Treasury rate is the  
 6           rate determined by the Secretary based on the aver-  
 7           age market yield (during any 1-month period se-  
 8           lected by the Secretary and ending in the calendar  
 9           month in which the determination is made) on out-  
 10          standing marketable obligations of the United States  
 11          with remaining periods to maturity of 3 months or  
 12          less.”

13          (b) CONFORMING REPEALS AND REDESIGNATIONS.—

14           (1) REPEALS.—The following subchapters of  
 15          chapter 1 of subtitle A and the items relating to  
 16          such subchapters in the table of subchapters for  
 17          such chapter 1 are repealed:

18           (A) Subchapter B (relating to computation  
 19          of taxable income).

20           (B) Subchapter C (relating to corporate  
 21          distributions and adjustments).

22           (C) Subchapter D (relating to deferred  
 23          compensation, etc.).

24           (D) Subchapter G (relating to corporations  
 25          used to avoid income tax on shareholders).

1 (E) Subchapter H (relating to banking in-  
2 stitutions).

3 (F) Subchapter I (relating to natural re-  
4 sources).

5 (G) Subchapter J (relating to estates,  
6 trusts, beneficiaries, and decedents).

7 (H) Subchapter L (relating to insurance  
8 companies).

9 (I) Subchapter M (relating to regulated in-  
10 vestment companies and real estate investment  
11 trusts).

12 (J) Subchapter N (relating to tax based on  
13 income from sources within or without the  
14 United States).

15 (K) Subchapter O (relating to gain or loss  
16 on disposition of property).

17 (L) Subchapter P (relating to capital gains  
18 and losses).

19 (M) Subchapter Q (relating to readjust-  
20 ment of tax between years and special limita-  
21 tions).

22 (N) Subchapter S (relating to tax treat-  
23 ment of S corporations and their shareholders).

24 (O) Subchapter T (relating to cooperatives  
25 and their patrons).

1 (P) Subchapter U (relating to designation  
 2 and treatment of empowerment zones, enter-  
 3 prise communities, and rural development in-  
 4 vestment areas).

5 (Q) Subchapter V (relating to title 11  
 6 cases).

7 (R) Subchapter W (relating to District of  
 8 Columbia Enterprise Zone).

9 (2) REDESIGNATIONS.—The following sub-  
 10 chapters of chapter 1 of subtitle A and the items re-  
 11 lating to such subchapters in the table of sub-  
 12 chapters for such chapter 1 are redesignated:

13 (A) Subchapter E (relating to accounting  
 14 periods and methods of accounting) as sub-  
 15 chapter B.

16 (B) Subchapter F (relating to exempt or-  
 17 ganizations) as subchapter C.

18 (C) Subchapter K (relating to partners  
 19 and partnerships) as subchapter D.

20 **SEC. 3. REPEAL OF ESTATE AND GIFT TAXES.**

21 Subtitle B (relating to estate, gift, and generation-  
 22 skipping taxes) and the item relating to such subtitle in  
 23 the table of subtitles is repealed.

1 **SEC. 4. ADDITIONAL REPEALS.**

2 Subtitles H (relating to financing of presidential elec-  
3 tion campaigns) and J (relating to coal industry health  
4 benefits) and the items relating to such subtitles in the  
5 table of subtitles are repealed.

6 **SEC. 5. EFFECTIVE DATES.**

7 (a) IN GENERAL.—Except as provided in subsection  
8 (b), the amendments made by this Act apply to taxable  
9 years beginning after December 31, 2007.

10 (b) REPEAL OF ESTATE AND GIFT TAXES.—The re-  
11 peal made by section 3 applies to estates of decedents  
12 dying, and transfers made, after December 31, 2007.

13 (c) TECHNICAL AND CONFORMING CHANGES.—The  
14 Secretary of the Treasury or the Secretary's delegate  
15 shall, as soon as practicable but in any event not later  
16 than 90 days after the date of enactment of this Act, sub-  
17 mit to the Committee on Ways and Means of the House  
18 of Representatives and the Committee on Finance of the  
19 Senate a draft of any technical and conforming changes  
20 in the Internal Revenue Code of 1986 which are necessary  
21 to reflect throughout such Code the changes in the sub-  
22 stantive provisions of law made by this Act.

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